



June 3, 2011

Ms. Jennifer J. Johnson, Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> and C Streets, N.W.  
Washington, DC 20551

Re: Docket No. R-1409; Regulation CC Revisions

Dear Ms. Johnson:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the proposal by the Federal Reserve Board (Board) regarding its proposed revisions to Regulation CC. By way of background, the California and Nevada Credit Union Leagues (Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members.

The Leagues support the goal of Congress and the Board to improve and streamline the check-processing system, including the check return process. We understand that since Regulation CC was first implemented there has been a dramatic migration from paper checks to an electronic interbank check collection and return system, largely brought about by provisions in the Check 21 Act. However, the system is still a far cry from being a fully-electronic one, and we are concerned that the proposal makes changes that do not take this reality into account. In fact, we believe the proposal would significantly increase fraud-related and compliance costs, especially for smaller credit unions, if adopted in its present form. Our concerns and recommendations are addressed below.

#### **Dodd-Frank Act Amendment**

The Leagues commend the Board for its straight-forward implementation of the Dodd-Frank Act provision increasing the amount of deposited funds from \$100 to \$200 for next business day availability. Our only recommendation regarding this provision is that the threshold be stated as an actual dollar amount (i.e., \$200) instead of using the term "minimum amount." We understand that the Board would like to minimize the number of references to specific dollar amounts in the regulation in order to facilitate future amendments. However, we believe a dollar amount reference provides much more readability and clarity to the rule than use of the term "minimum amount."

#### **Application of Funds Availability Rules to Remote Deposit Capture Deposits**

The Leagues support the approach in the proposal to not apply the funds availability provisions contained in subpart B of the regulation to Remote Deposit Capture (RDC) deposits. Consistent with FFIEC guidance issued on RDC risk management, financial institutions should have the flexibility to determine all issues relating to the RDC deposit, including method and timing of receipt, funds availability, and possible holds on the deposit of check images. Accordingly, the FFIEC guidance places strong emphasis on the need of financial institutions to have contracts in place with its RDC users in order to address these types of issues. We agree with this approach, and request that the Board provide in the final rule a statement that clearly states RDC deposits are not subject to subpart B of Regulation CC.

### **Deposits at Nonproprietary ATMs**

Under the proposal the general hold for nonproprietary ATM deposits would be shortened from five business days to four business days. As part of this proposed action, the Board also requests comment as to whether or not there is support for maintaining the distinction between proprietary and nonproprietary ATMs. The Leagues believe that the current distinction between proprietary ATMs and nonproprietary ATMs should be maintained. While many ATMs are being enabled with image deposit capability, there are still ATMs that accept paper checks for deposit that cannot be truncated to images at the point of deposit. As a result, credit unions and other financial institutions may still experience delays in waiting for settlement or processing of checks that are deposited at non-proprietary ATMs. Further, we do not support the proposed shortening of the hold for nonproprietary ATM deposits, as they present unique fraud and risk loss exposure, especially for credit unions. The additional hold periods on deposits at nonproprietary ATMs are necessary because ATM deposits often cannot be verified and are frequently in remote locations. The Board has not provided data showing the need for this reduction in hold time, or that doing so would not increase fraud and risk exposure for credit unions and other financial institutions.

### **Reduction of Exception Hold Period**

The Board proposes to reduce the safe harbor reasonable hold extension for most checks from five business days to two business days, for a total of four business days (i.e., a two business day hold permitted for a local check, plus a two business day hold for invoking one of the exceptions under the regulation). The Leagues strongly disagree with reducing this important check hold provision. While check image processing has grown dramatically in recent years, the financial services industry has been operating as a single check processing region for a short period of time, and there are still situations where it will take longer than four business days to collect an item, even using electronic collection methods.

Many of our member credit unions—even those utilizing image processing—report that it takes more than four business days to receive returned items back. This may occur, for example, where an item has been fraudulently altered to delay its collection and return (e.g., the item bears a fictitious or non-matching routing number and account), or where there is another problem with the electronic collection or return and manual intervention is required. Many credit unions automatically resubmit non-sufficient funds items in an attempt to collect on them, which further extends the return timeframe. In addition, if items subject to a deposit hold exception are collected and returned in paper process, the time period for the forward and return process may extend beyond four business days.

The Leagues have also reviewed survey data provided to the Board in comments from the Electronic Check Clearing House Organization (ECCHO) which confirms our credit unions' experience. Based on this information and the input of our member credit unions, we believe that it is unrealistic and premature at this time to reduce the safe harbor reasonable hold period. As with nonproprietary ATM holds, it is our position that a reduction should be made only if there is no undue increase in fraud risk and loss exposure for depository institutions. Any reduction in hold periods should be phased in gradually over multiple years to minimize this exposure. We

recommend that the Board conduct a study of arrival rates of unpaid returned checks at the bank of first deposit before proposing to reduce these hold times.

#### **Elimination of “Refer to Maker” Return Reason Code**

The proposal would prohibit a paying institution from using the return reason code “refer to maker” on a standalone basis. The Leagues do not support such a prohibition, and recommend that the Board delete it for the following reasons:

- In some situations, there is no other return reason code to better describe the reason for a return. Some situations where credit unions use this code include:
  - Account hold
  - Improper endorsement
  - Missing signature
  - Invalid account/unable to locate account
  - Stale dated item
  - Fraud on account
- We believe that the permissibility of certain return reasons is best addressed by industry standards groups. This could be done as part of an effort to evaluate the necessity and effectiveness of all return reason codes, and would obtain input of all industry stakeholders.
- The elimination of this return reason code would require substantial procedural and systems changes on the part of paying institutions. These changes will take considerable time and expense.

#### **Effective Dates**

Under the proposal, revised subparts A and B (definitions and availability of funds) take effect 30 days following publication of the final rule. Credit unions and other institutions would have 12 months to comply with the amendments to subpart B and the model forms in appendix C, and amendments to subparts C and D (collection of checks and substitute checks) would become effective six months following publication of the final rule. The Leagues thank the Board for recognizing that updating funds availability policies and disclosures is costly and burdensome, and for providing a 12 month compliance period for these proposed revisions. This is especially important for smaller institutions that are attempting to comply with numerous other Dodd-Frank and regulatory changes, including the required changes to next day availability.

While we generally support the six month delayed effective date for subparts C and D of the rule, we believe that substantially more time is needed to actually implement these changes, which would include the proposed elimination of the standalone return reason code “refer to maker.” Any changes to the permissible return reason codes under subpart C will require programming and systems changes to financial institutions’ systems. This process is likely to take significantly longer than six months, especially given the number of regulatory changes that are already straining the

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limited resources of credit unions. Therefore, the Leagues recommend a minimum compliance date for subparts C and D of 18 months.

In closing, we thank you for the opportunity to provide our views and recommendations. Before finalizing a rule, we encourage the Board to work with credit unions and other financial institutions to obtain data on this issue beyond merely the number of checks processing electronically, and to look deeper into issues such as processing times of unpaid returned checks, the impact of check fraud on processing, changes in counterfeit technology, and other critical factors of the payment landscape. We appreciate the efforts of the Board on this issue to date, and look forward to working with the agency to craft a more realistic and fair rule.

Sincerely,

A handwritten signature in black ink, appearing to read 'Diana R. Dykstra', with a large, stylized flourish at the end.

Diana R. Dykstra  
President/CEO

cc: League Member CEOs